



Economic Update

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Economy Showing Greater Strength in Second Half

The U.S. economy is growing at a faster pace in the second half of the year, with tax relief helping to boost consumer and business spending. Evidence is also beginning to emerge that the stronger economy is leading to improvements in labor markets. Although a specific quarter's or month's data should not be given inordinate weight, key indicators are beginning to show, more consistently, positive trends. Overall, the outlook has improved, and most forecasters expect a continued stronger economy with falling unemployment and increasing jobs.

Recent Data Show Improving Economy, Early Signs of Job Growth

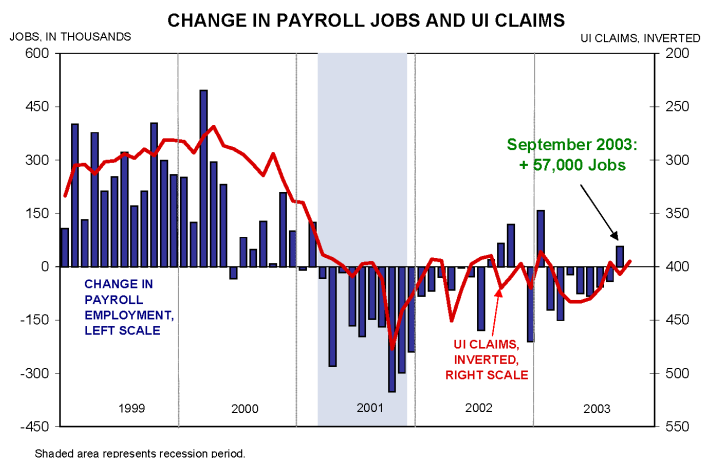
- **GDP Growth:** Real gross domestic product [GDP] grew 3.3 percent at an annual rate in the second quarter, an upward revision from the preliminary estimate of 3.1 percent – and a markedly faster pace than the 1.4 percent of the prior two quarters.
- **Labor Markets:** Nonfarm payroll jobs increased by 57,000 jobs in September, and the unemployment rate

remained at 6.1 percent. Private jobs increased by 72,000, while government jobs decline by 15,000, yielding the net 57,000-job increase.

The report was better than expected: private analysts had expected payroll jobs to decline by 25,000 jobs in September, and the unemployment rate to increase to 6.2 percent. In addition, the decline in payroll jobs in August was revised down to 41,000, instead of the 93,000-job loss in the previous month's report.

Unemployment insurance claims have begun to show some signs of improvement, dropping below the key 400,000 level in several recent weeks. The lower level of claims bodes well for payroll job gains (see chart).

- **Income and Consumption:** Disposable personal income increased strongly in July and August as a result of the reduction in taxes from the Jobs and Growth Tax Relief Reconciliation Act of 2003. The tax plan reduced withheld taxes by \$7.6 billion in July and August, and also added \$13.7 billion to disposable incomes through the advance payments of increased child tax credits.



The data point to real consumption spending growing at a strong pace in the third quarter – at as much as a 5-percent to 6-percent annual rate. The data indicate that about two-thirds of the tax relief in July and August was spent in those months. This result contrasts with earlier concerns, expressed by some analysts, that the tax plan failed to sufficiently target families who would spend it readily, and that it therefore would not provide a boost to the economy.

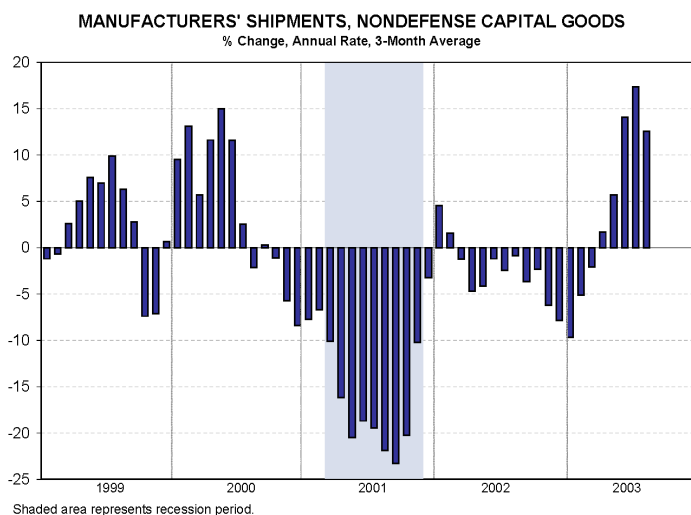
- **Manufacturing and Nonmanufacturing Activity:** The Institute for Supply Management reported that its manufacturing purchasing managers index declined slightly to 53.7 in September, from 54.7 in August; but

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it remained above the neutral level of 50 (a level of 50 indicates the sector is neither contracting nor expanding). The index of nonmanufacturing activity fell slightly in September to 63.3 down from August's 65.1. Continued growth in manufacturing and stronger growth in the service sector are expected with both indexes continuing above

the neutral level of 50. New orders and shipments for manufacturers' durable goods have increased sharply in recent months – although showing a partial backtrack in August (see chart). These increases in business equipment spending coincide with the investment tax incentives of “bonus depreciation” that were enacted last year and extended earlier this year.

- *Structural Investment:* Residential housing construction continues to run at a historically strong pace. In contrast to the marked improvements in other sectors,



Blue Chip Economic Outlook, October 2003

	2003.1	2003.2	2003.3	2003.4	2004.1	2004.2	2004.3	2004.4
	--- History ---		----- Projection -----					
Real GDP Growth	1.4	3.3	4.9	3.7	3.8	3.7	3.8	3.5
Unemployment Rate	5.8	6.2	6.2	6.2	6.1	6.0	5.9	5.8
CPI Inflation	3.8	0.7	2.0	1.7	1.8	1.8	2.0	2.1
3-month Treasury Bill	1.2	1.0	1.0	1.0	1.1	1.2	1.5	1.9
10-year Treasury Note	3.9	3.6	4.3	4.4	4.5	4.7	4.8	5.0

Note: Unemployment and interest rate values for 2003.3 are actuals and not projections.

however, business construction spending has been stagnant over the past year, following the sharp declines before and during the recession.

- *Higher Stock Market Values:* Broad indexes of stock market valuations have shown substantial increases over the past 6 months: the S&P 500 index, for example, has risen nearly 30 percent.

Outlook for Continued Stronger Growth

Private forecasters expect that the economy grew at a strong pace in the third quarter just ended, with real GDP growing at about a 5-percent annual rate (the government's initial estimates of third quarter GDP will be released at the end of this month). As discussed above, tax relief is contributing to a large increase in real consumption spending and higher business investment in the third quarter. These gains are major reasons that private analysts are expecting strong real GDP growth.

Looking forward, the private forecasters surveyed by Blue Chip Economic Indicators expect that real GDP growth will be in the 3½-percent to 4-percent range through the end of next year (see table). Growth at that pace is expected to lead to improvements in labor markets with the unemployment rate gradually declining to about 5.8 percent by the end of next year. Consumer price index [CPI] inflation is expected to remain subdued, at roughly 2.0 percent. Interest rates are expected to rise gradually with the improving economy.

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